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Person To Contact:

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Date:

December 29, 2005

Legend:

Utility =

Agreement =

District =

Bonds =

Authority =

Date 1 =

Date 2 =

Date 3 =

a =

b =

c =

d =

Dear

This is in response to your request for a ruling that use of the facility described below by the Utility pursuant to the Agreement does not result in the private business use of the Facility within the meaning of § 141 of the Internal Revenue Code (the “Code”) because the Agreement is a swapping arrangement with the meaning of § 1.141-7(f)(2) of the Income Tax Regulations.

Facts and Representations

The District, a political subdivision of the State with substantial eminent domain powers, is a retail water provider to persons and entities located within the District’s service area. The District is a member of the Authority, a wholesale provider of water to governmental water purveyors within the State. The District is authorized to issue bonds in order to loan the proceeds to the Authority.

On Date 1 and Date 2, the District issued the Bonds and loaned the proceeds to the Authority. The Authority used the Bonds to acquire an a percent undivided interest in a newly constructed approximately b megawatt generating plant (the “Facility”). The Authority, a large consumer of electrical energy, acquired the Facility in order to have a certain supply of electrical energy and to stabilize the price it pays for the electrical energy it consumes.

After operating the Facility for a short time, the Authority determined that the power produced by the Facility was not ideal for the Authority’s needs because such power is produced only when the Facility is operating. The Authority determined that it required a source of electrical energy not dependent on whether a particular plant is operating. In order to better suit the Authority’s power consumption needs, the Authority, effective as of Date 3, entered into the Agreement with the Utility.

Pursuant to the terms of the Agreement, the Utility has the right to the capacity of and the energy produced by the Facility during all hours for c years. The Utility must provide or pay for the variable costs of the production of electricity at the Facility including the costs of fuel for the Facility and the Facility’s variable operating and maintenance costs.

In return, the Utility promises to supply the Authority, throughout the term of the Agreement, with d megawatts per hour of firm power available 24 hours a day, 7 days a week. The Authority must pay for the variable costs of providing this electricity including the fuel necessary to provide this energy as well as the variable operating and maintenance costs associated with producing this power. Both the fuel costs and the cost of operation and maintenance per megawatt hour of energy produced will be calculated using the rates that would have been applicable if the power to be provided to the Authority pursuant to the Agreement had been produced at the Facility.

The Authority expects that the value of the swapped output will be approximately equal in value for each two year period during the term of the Agreement.

The Agreement provides that the Authority and the Utility have entered into the Agreement in order to, *inter alia*, enable the Authority and the Utility to satisfy different peak load demands, to accommodate temporary outages, to diversify supply, and to enhance reliability in accordance with prudent industry practice. With respect to the Authority, the Agreement will primarily diversify supply because the Utility has numerous facilities with which to produce the power to be supplied to the Authority. With respect to the Utility, the Agreement will primarily enable the Utility to enhance reliability in accordance with prudent industry practice. In order to achieve reliability with respect to the generation of electricity, generators must have reserves of capacity for generating or providing energy as needed.

Law & Analysis

Section 103(a) provides that, except as provided in §103(b), gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that §103(a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of §141).

Section 141(a) provides that the term “private activity bond” means any bond issued as part of an issue which meets (1) the private business use test of §141(b)(1) and the private security or payment test of §141(b)(2), or (2) the private loan financing test of §141(c).

Section 141(b)(1) provides that, except as otherwise provided, an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(6)(A) defines “private business use” as use (directly or indirectly) in a trade or business carried on by a person other than a governmental unit. Section 1.141-3 provides that the 10 percent private business use test is met if more than 10 percent of the proceeds of an issue is used in a trade or business of a nongovernmental person.

Section 141(b)(2) provides that, except as otherwise provided, an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by an interest in (i) property used or to be used for the private business use or (ii) payments in respect of such property or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 1.141-7 sets forth rules to determine whether arrangements for purchases of output from an output facility cause an issue of bonds to meet the private

business tests. An output facility is defined by § 1.141-1(b) as electric and gas generation, transmission, distribution, and related facilities, and water collection, storage, and distribution facilities. Section 1.141-7(c)(1) provides that the purchase pursuant to a contract by a nongovernmental person of available output of an output facility financed with the proceeds of an issue is taken into account under the private business tests if the purchase has the effect of transferring to the nongovernmental person the benefits of owning the facility and the burdens of paying the debt service on the bonds used (directly or indirectly) to finance the facility (the “benefits and burdens test”).

Section 1.141-7(c)(2) provides that the benefits and burdens test is met if a nongovernmental person agrees pursuant to a take contract or a take or pay contract to purchase available output of a facility. Section 1.141-7(b)(4) provides the following definition of a take contract or a take or pay contract. A take contract is an output contract under which a purchaser agrees to pay for the output under the contract if the output facility is capable of providing the output. A take or pay contract is an output contract under which a purchaser agrees to pay for the output under the contract, whether or not the output facility is capable of providing the output.

Section 141-7(f)(2) provides that an agreement providing for swapping or pooling of output by one or more governmental persons and one or more nongovernmental persons does not result in private business use of the output facility owned by the government person to the extent that (1) the swapped output is reasonably expected to approximately equal in value (determined over a period of three years or less) and (2) the purpose of the agreement is to enable each of the parties to satisfy different peak load demands, to accommodate temporary outages, to diversify supply, or to enhance reliability in accordance with prudent reliability standards.

The Agreement does not result in the private business use of the Facility because the output and capacity to be provided to the Utility is reasonably expected to be approximately equal to the power to be received by the Authority determined over a period of less than three years. In addition, the purpose of the Agreement is to enable each of the parties to satisfy different peak load demands, to accommodate temporary outages, to diversify supply, or to enhance reliability in accordance with prudent reliability standards. With respect to the Authority, the Agreement will primarily diversify the supply received by the Authority because of the availability of all of the Utility’s resources to produce the power delivered to the Authority. With respect to the Utility, the Agreement will enhance the reliability of the Utility’s generation system in accordance with prudent reliability standards by providing additional capacity which can be accessed by the Utility as needed.

Conclusion:

We conclude that the use of the Facility by the Utility pursuant to the Agreement does not result in the private business use of the Facility within the meaning of §141 because the Agreement is a swapping arrangement within the meaning of §141-7(f)(2).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Powers of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Governmental Entities)

By: _____

Timothy L. Jones
Senior Counsel, Tax Exempt Bonds Branch